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ABSTRACT

At its October 2002 meeting, the Texas Higher Education Coordinating Board discussed the effects of recent trends in higher education financing on the state's ability to achieve the goals of the state's higher education plan, "Closing the Gaps." This paper, prepared as a "next step" agenda item at the January 2003 Board meeting, provides the basis for a possible policy recommendation to the Texas Legislature regarding the appropriate balance among appropriations to institutions, financial aid, and charges to students. The recommendations are based on the key principles of flexibility, adequacy of funding, and adequacy of financial aid. It is suggested that as long as the average charge to students is not raised or lowered significantly, institutions should have flexibility in setting charges to students. Increased charges that might result from tuition flexibility should result in a net increase in revenue to institutions, and it must be recognized that the state's system of higher education must continue to be affordable for the citizens of Texas. (Contains 15 references.) (SLD)

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Financing Higher Education: The Appropriate Balance among Appropriations, Tuition and Fees, and Financial Aid to Achieve the Goals of *Closing the Gaps*

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Texas Higher Education Coordinating Board
March 2003

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Executive Summary

At its October 2002 meeting, the Texas Higher Education Coordinating Board discussed the effects of recent trends in higher education financing on the state's ability to achieve the goals of *Closing the Gaps*, the state's higher education plan. This paper, prepared as a "next-step" agenda item at the January 2003 Board meeting, provides the basis for a possible policy recommendation to the Texas Legislature regarding the appropriate balance among appropriations to institutions, financial aid, and charges to students.

These recommendations would apply to Texas public two-year colleges and universities only and would not apply to health-related institutions. Further, this should be viewed as recommendations for the long-term direction for development of these institutions, not recommendations that would necessarily be implemented in a single biennium.

The state's policies on higher education funding, charges to students (particularly, tuition and fees), and financial aid must be consistent and work together to meet the state's goals effectively and efficiently. As in most other states, Texas does not have an integrated or planned approach to how these financing elements should work together, but the issue of how to balance these elements is receiving attention across the nation (See, for example, *Accounting for State Student Aid: How State Policy and Student Aid Connect*, 2002, and *Ensuring Access Through Integrated Financing Policy*, 2002). A balanced financing policy would link state polices related to higher education funding, charges to students, and financial aid in a way that would provide institutions the funds they need to achieve the four goals of Closing the Gaps, while charges to students are set so that financial aid resources are used effectively to help students with financial need participate and succeed in higher education.

The discussion that follows considers the four related questions which must be answered to establish an integrated financing policy:

(1) At what levels should gross charges to students be set?

(2) What percentage of gross charges should be covered by financial aid ... and by what types of financial aid?

(3) How much revenue is needed by institutions of higher education to achieve the goals of Closing the Gaps?

(4) What percentage of Educational and General funding should come from state sources and what percentage should come from other sources?

The following summary recommendations focus on three key principles, all directly aligned with *Closing the Gaps*: Flexibility, Adequacy of Funding, and Adequacy of Financial Aid. The performance system for the state's higher education plan, *Closing the Gaps*, should be used to measure how well the state's system of higher education is working.

These principles are recommended as the basis for a balanced financing policy for Texas public colleges and universities.

- ***(1) Flexibility in setting charges to students. As long as the average charge to students is not raised or lowered significantly, all institutions of higher education should have flexibility in setting charges to students for the purposes of increasing efficiency and achieving the participation, success, excellence, and research goals of Closing the Gaps. The flexibility to increase average charges to students should be given to institutions when specific conditions are met to preserve and enhance affordability and meet the goals of Closing the Gaps.***

The first type of flexibility would allow institutions to give discounts to students taking courses in off hours and offer flat rate tuition to encourage students to complete their degrees more quickly. The second type of flexibility would allow institutions to increase charges to students, as long as they met certain conditions.

General academic institutions should be given flexibility to set charges to students if they enter into a compact with Texas that guarantees maintaining affordability and meeting the central targets of the *Closing the Gaps* plan, including closing the gaps in participation and success for major demographic groups of Texans.

Each group of institutions should address a different educational marketplace:

Two-year colleges should continue to provide a low-cost portal to a wide range of academic and technical higher education services.

Comprehensive universities should maintain current levels of affordability and offer quality teaching programs.

Doctoral/research universities should be developed as higher-tuition/higher- financial-aid institutions offering national-quality teaching and research programs.

- ***(2) Adequacy of funding. To ensure that each institution of higher education receives adequate funding to meet Closing the Gaps' goals, increased charges to students that might result from tuition flexibility should result in a net increase in revenue to institutions.***

Greater flexibility to raise tuition should not become simply a way to shift the cost of higher education from the state to the student.

The higher education financing system should also contain more structural incentives that encourage institutions to increase revenue streams from sources other than general revenue, including research funding, royalties from intellectual property, and other activities.

- ***(3) Affordability: Adequacy of Financial Aid. The state's system of higher education must continue to be affordable for the citizens of Texas. Affordability is essential to most of the goals of*** Closing the Gaps. ***Gift aid needs to increase to match rising tuition and fees for students with financial need. Student loans should not substitute for low charges to students and need-based gift aid. Students enrolled in the first two years of undergraduate education, particularly, should be the main priority for the state's need-based gift aid.***

It would be highly desirable to pursue a joint guarantee from the state and institutions to provide grant aid to cover tuition and fees for students who have completed the recommended high school curriculum and whose family income is below a specified level. For students who have completed the recommended high school curriculum and whose family income is at or above a specified level, such grant aid may be provided.

Each of these recommendations is discussed in detail in subsequent sections of this document.

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Background

At its January 2001 meeting, the Coordinating Board adopted a policy to encourage the continued affordability of Texas higher education and help meet the participation and success goals of *Closing the Gaps*, the state's higher education plan. The policy has met with mixed success, in that it does not appear to have slowed the increases in charges to students, at least in universities.

At its October 2002 meeting, the Board discussed the effect of recent trends in higher education financing on the state's ability to achieve all the goals of *Closing the Gaps*.

"Consideration of the most appropriate balance of appropriations, tuition and fees, and financial aid," which was Agenda item VI-A (1) for the January 2003 Coordinating Board meeting, was the next step in these discussions. This agenda item was intended to lead to a possible policy recommendation to the Texas Legislature regarding the appropriate balance among appropriations to institutions, charges to students, and appropriations for financial aid to meet *Closing the Gaps* goals. Drafts of this report were distributed to institutions for review and comment. The Coordinating Board discussed a draft of this report at its January 2003 meeting and delegated final approval to its Committee on Administration and Financial Planning.

The recommendations included in this report apply only to Texas public two-year colleges and universities and do not apply to health-related institutions. Further, this should be viewed as a recommendation for the long-term development of these institutions, not as recommendation to be implemented in a single biennium.

Texas and other states are facing severe budget crises. States tend to reduce public funding to higher education institutions while raising tuition and fees during such periods – which often coincide with economic downturns that affect students' and families' ability to pay[1]. The right balance among these elements would provide institutions the funds they need to move toward each of the four goals of *Closing the Gaps*, while ensuring that students with financial need are able to participate and succeed in higher education. Achieving the right balance requires establishing what David Longanecker, executive director of the Western Interstate Commission for Higher Education (WICHE), calls an "integrated financing policy." An integrated financing policy creates an intentional linking of all three of the elements discussed here: higher education appropriations, financial aid, and tuition and fees[2].

This report differentiates among three groups of institutions: (a) two-year colleges; (b) doctoral/research universities, which could be defined in a number of ways; and (c) comprehensive universities, which would include all other public universities.

For this report, "appropriations to institutions" refers to State general revenue appropriated directly to institutions. "Charges to students" refers to tuition and fees plus other charges to students that support educational and general activities, including incidental and other fees that do not flow through the appropriations process. This category does not include fees for auxiliary enterprises such as dormitory rentals, food service fees, bus fees, recreational

[1] The recent study by Cunningham, et. al. for The Institute for Higher Education Policy documents the trend, in recent years, for tuition increases to make up slowly but steadily declining state support for higher education.
[2] Longanecker, 2002, pp 1-3.

sports fees, and similar items. "Student financial aid" includes gift aid from all sources, including state and federal governments, foundations, and institutional endowments – but does not include student loans.

Affordability

Much of the interest in trying to determine the best balance among various revenue sources derives from a marked decrease in public higher education affordability in Texas in recent years. Defining affordability as average charges to students for a full-time-student-equivalent as a percentage of the median income for a Texas family of four, the following table shows how Texas higher education has become less affordable since 1990:

Charges to Texas Students as a Percentage of Median Family Income

Sector	FY 1990	FY 1995	FY 2000	FY 2001
Doctoral/Research Universities	3.4%	5.1%	7.5%	8.4%
Comprehensive Universities	2.6%	3.6%	4.8%	5.2%
Two-year Colleges	Not Available	2.4%	2.6%	2.8%

Source: US Census data and institutional financial reports. Charges to students were determined by dividing total tuition and fees collected by full-time student equivalents.

Price Responsiveness Studies

Educational researchers have, over a long period, examined the relationships among charges to students, student financial aid, and student enrollments. In general, increases in tuition produce decreases in enrollment. Increasing financial aid, which is equivalent to decreasing charges to *some* students, usually results in increased enrollment. These are broad generalizations, because numerous other factors also affect enrollment. For example, Texas enrollment increased substantially in Texas institutions after charges to students increased in FY 2003.

Efforts to quantify these relationships are called "student price responsiveness" studies or "student price elasticity" studies. Such a study has not been done in Texas, but a recent study in California [Heller, 2001] found that a 10 percent increase in tuition would lead to a 0.52 percent decrease in enrollment at four-year institutions and a 1.34 percent decrease in enrollment at two-year institutions. To offset those enrollment decreases, a 15.9 percent increase in per-capita student financial aid would have been required at four-year institutions and a 129 percent increase would have been required at two-year institutions. While conditions in California may be different than in Texas, the general observation that enrollments at two-year colleges are more sensitive to increases in tuition than enrollments at four-year universities almost certainly applies as well to Texas.

Flexibility in Assessing Charges to Students

Texas institutions have been given a significant amount of flexibility in assessing tuition and fees in recent years, although the Legislature continues to set base, statutory tuition rates. Most, but not all, institutions desire additional flexibility in setting charges to students. Two types of additional flexibility are desired: (1) flexibility that would allow them to vary charges to change student behavior in ways that enhance efficiency to reallocate resources to meet the goals of *Closing the Gaps*, and (2) flexibility that would allow them to increase charges to students primarily for the purpose of raising additional revenue to improve achievement in meeting the goals of *Closing the Gaps*. Giving institutions flexibility in assessing charges to students can lead to more efficient use of facilities and other resources. For example, flat tuition rates can encourage students to take more hours and graduate sooner, and lower tuition rates for classes offered at unpopular and nontraditional times encourages better use of existing facilities. Additional flexibility to raise charges may result in additional needed revenues for higher education, without compromising affordability or access to higher education. For example, some doctoral/research universities could probably increase charges without suffering a decline in enrollment. Even after providing additional financial aid to support students with need, there could be a net gain in revenue to support more expensive programs. Any new policy should encourage institutions to be innovative in using price to manage demand for efficiency purposes, so long as overall affordability is not compromised.

Student Loans as Financial Aid

The ready availability of student loans is one of the reasons that tuition and fees have been allowed to increase so rapidly. Many legislators and institutional administrators seem to believe that they can raise charges to students without affecting access, because students can get student loans if necessary. Over the past 20 years, there has been a dramatic shift from gift aid to loans. This has been true both in Texas and nationally. During the 1990's, the average level of student debt in the nation for baccalaureate graduates nearly doubled to $16,928.

While loans help students who are willing to incur debt, studies are re-evaluating the effects of the shift from gift aid to loans. Loans tend to shift the burden of paying for college from parents to students, which is perceived as inappropriate by some people. Numerous studies show that low-income and minority students (and their parents) are less willing to assume loans than are higher-income students. Student debt levels have risen far faster than salaries of college graduates, and many students accumulate debts that cripple them financially for years after leaving school. According to a study completed last year,[3] 39 percent of students are now graduating with unmanageable levels of student debt (defined as more than 8 percent of their monthly income). This figure represents more than one-half of the 64 percent of students who are graduating with student loan debt. Also, low-income students who do not graduate find it extremely difficult to repay their loans. Finally, students are given little or no financial counseling when they take student loans, which cannot be discharged by surrendering collateral or even by personal bankruptcy.

The TEXAS Grant program marks a recent shift in student aid from loans to gift aid, but student loans are still much more available than gift aid.

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[3] King and Bannon, p.1.

Four documents are suggested for further information. The first is *Empty Promises: The Myth of College Access in America*, issued in June 2002 by an independent committee created by Congress and chaired by The University of Texas at Brownsville president Juliet Garcia to provide advice on higher education and student aid. This report dramatically documents the shortfalls of the current financial aid system in providing access to low-income students.

The second is *The Tuition Puzzle: Putting the Pieces Together*, issued in 1999 by The Institute for Higher Education Policy with additional support from The Ford Foundation and The Education Resources Institute. This study describes how higher education revenues and expenditures have changed across the nation in recent years and makes a number of recommendations that are similar to those made in this report.

The third is *The Effects of Tuition Prices and Financial Aid on Enrollment in Higher Education: California and the Nation*, published in 2001. This study summarizes the literature and provides independent research on the elasticity of demand as it relates to varying charges to students and varying amounts of student financial aid. While the study focuses on California, much of it is relevant to Texas.

The fourth is *2001-02 Tuition and Fee Rates: A National Comparison*, a study conducted by the Washington Higher Education Board and published in December, 2002. The data, while not perfect, indicate that recent increases in undergraduate tuition and fees have raised the cost of an undergraduate education in Texas to close to the national average, but that Texas remains very inexpensive with regard to graduate and professional tuition.

Institutional Improvement through Benchmarking

One of the most effective management practices adopted in recent years is the use of benchmarking or best practices. Business, industry, and government use benchmarking in a wide variety of applications. Essentially, they find a high-quality, low-cost producer and adopt the processes or "best practices" being used.

The National Center for Public Policy and Higher Education *State-by-State Report Card for Higher Education* is one measure of the effectiveness of each state's higher education system. Of the ten largest states other than Texas, this measure rates California and Illinois as the two highest performing states. California is also the state most similar to Texas in demographics, business climate, and growth rates. The 2002 edition of the *Report Card* gives the following grades for California, Illinois, and Texas:

Category	California	Illinois	Texas
Preparation	C-	B+	C+
Participation	B+	A	D+
Affordability	A	B	D+
Completion	C+	B-	C-
Benefits	A-	B-	C+

Although there is not universal agreement on the accuracy of the *Report Card* grades, this report suggests that both California and Illinois do a better job in the participation, affordability, completion, and benefits categories than Texas and that California does it with

students who are less well prepared than Texas students. This paper proposes that some of the best practices of the California and Illinois systems be adopted in Texas.

Tuition-setting authority in other states

The role of state legislatures in controlling charges to students varies among states. In some states, the legislature controls tuition but not fees, others control both tuition and fees, and some control neither.

In 2000, the State Higher Education Executive Officers (SHEEO) conducted a survey of tuition and fee policies. The survey did not directly address the question of what entity establishes tuition and fee levels. It did indicate that 11 states had tuition policies embedded in their constitutions or in statutes. In at least18 states (Arkansas, Arizona, California, Florida, Hawaii, Kansas, Idaho, Louisiana, Massachusetts, Nevada, New Mexico, North Carolina, North Dakota, Rhode Island, South Dakota, Texas, Utah, Virginia, Wisconsin), tuition revenues are deposited in a fund from which they must be appropriated to institutions before they can be used or are controlled by a statewide coordinating or governing board, indicating a significant level of legislative control. In some states in which tuition revenue is controlled by the institution, legislatures have stepped in to impose tuition caps or other restraints, again indicating that many legislatures include oversight of charges to students among their responsibilities.

However, over the past 20 years, the trend in Texas and the nation has been to provide governing boards more control over charges to students and the use of revenue derived from charges to students.

Impact on other higher education programs

Besides the direct effects on students and their parents of changes in tuition and fees, changes have the potential to affect other programs and entities indirectly. Some of these indirect effects include the following:

- Texas Prepaid Tuition Program (Texas Tomorrow Fund). This fund is predicated on an assumption that the Legislature would allow tuition and fees to increase at historical rates. A major increase in tuition and fees would affect the ability of the fund to meet its obligations without supplementary legislative appropriations.
- TEXAS Grants. Increases or decreases in tuition and fees would affect the number of these grants that could be awarded each year.
- Bonding capacity and bond ratings. University systems use tuition and fee revenue to service bond debt. Reductions in this revenue would negatively affect institutions' ability to service this debt. Conditions placed on the authority of institutions to increase tuition and/or fees could negatively affect bond ratings, which would in turn increase the cost of borrowing.
- Federal funds. Most need-based financial gift aid is provided by the federal government in the form of Pell or other grants. In general, increases in charges to students would make them eligible for larger grants. Because the allocation to each state is based on need in a prior year, increasing charges to students would have the short-term effect of

decreasing the number of students eligible for these grants but a long-term effect of increasing Texas' allocation of these funds.

- Local community college districts. Local community college districts currently have broad authority to set both local tax rates and charges to students. Conditions placed on the authority to set tuition and fees would re-define the relationships that exist between these districts and the State and might require institutions to increase local taxes if the conditions were not accompanied by increases in State appropriations.

Questions to be addressed

Subsequent sections of this document address four questions that together form the basis for a balanced higher education financing policy:

- At what levels should gross charges to students be set?
- What percentages of gross charges should be covered by financial aid…and by what types of financial aid?
- How much revenue is needed by institutions of higher education to achieve the goals of *Closing the Gaps*?
- What percentage of Educational and General funding should come from state sources and what percentage should come from other sources?

At what levels should gross charges to students be set?

Most of the discussion in this section focuses on resident undergraduate tuition rates. In later sections, some attention will be given to the balance between tuition for undergraduate students and tuition for graduate and professional programs.

Traditionally, higher education administrators have taken the position that the level of funding needed to provide quality programs should be assessed before determining the mix of government appropriations and charges to students necessary to meet that need. When public funds are in short supply, state legislatures often choose to meet higher education funding needs of institutions by authorizing increased charges to students, leading to the problems described in the previous section of this report.

Establishing the appropriate level of charges to students is, therefore, appropriate as the first step in the development of a state plan for financing higher education. The following principles apply when determining what that level should be:

- Higher education is both a private and a public good, and the responsibility for financing higher education should be shared between taxpayers (public good) and the recipients of higher education (private good).

- Overall, tuition and fees should be set in a way that promotes the goals of *Closing the Gaps*.

- Institutions should have flexibility in assessing charges to students for such things as block tuition and reduced charges for classes in underused facilities as methods for achieving greater efficiency.

- Charges to students should be set at a level that makes borrowing money to pay for higher education a good long-range decision for students and their parents.

- Students enrolled in advanced, graduate, or professional programs that are more expensive to offer and that prepare them for high-income positions should pay more in tuition and fees than students in programs that prepare them for lower-income positions.

- All other things being equal, charges to students should be formulated in a way that maximizes the use of federal financial aid.

- To ensure that Texas taxpayers are not inappropriately subsidizing the educations of out-of-state students, a substantial portion of non-resident students should pay non-resident tuition.

- Charges to students should reflect knowledge about the elasticity of demand for higher education as fees are raised and financial aid is provided.

Based on these principles, several recommendations are offered. They suggest that the state set limits on the amount of revenue collected from students but give institutions more flexibility in determining how and from whom they collect that revenue. The recommendations follow:

- Two-year colleges should provide a low-cost portal to a wide range of academic and technical higher education services.

  Charges to students at Texas two-year colleges are generally low in comparison to many other states, but there is considerable variation from district to district.

  The Comptroller has recommended that students should be able to attend two-year colleges at no cost. That policy would improve participation levels but could also introduce large numbers of marginally-motivated students into a system that is already stressed by high enrollments and might jeopardize the state's success goals. Establishing tuition and fees at levels similar to two-year institutions in California would be a movement toward the goal of free tuition and would also support the goals of *Closing the Gaps*.

  The major difference in evaluating the affordability of higher education in Texas and California is in a metric that measures the share of income that the poorest families need to pay for tuition at the lowest-priced colleges. Because two-year colleges in California charge low rates, they are able to meet the needs of low-income children and adults better than any other state in the U.S.

  Low charges to students at two-year institutions are consistent with the Carnegie Commission and the Institute for Higher Education Policy recommendations that taxpayers should bear a greater share of the costs of lower-division instruction, and that greater college cost differentiation based on level of instruction should be encouraged. This is a key recommendation for supporting the *Closing the Gaps* goals of increasing participation and success. The National Center for Public Policy and Higher Education report card indicates that Texas compares poorly to most other states in participation rates for all groups but especially for adults. Because this group is unlikely to be eligible for financial aid and because their enrollment decisions are very sensitive to cost, low charges to students are an important tool for improving participation rates, especially among adults. Reducing charges to students may result in more minimally qualified students in the system, making it more difficult to achieve the Board's success goals, but Texas participation rates are sufficiently low that it is a risk worth taking.

  Capping or lowering charges to students at two-year colleges would be difficult given that two of the main revenue streams for community colleges – tuition and community college property taxes – are set locally. In some communities, high tax rates or high property tax bases allow for low tuition. In others, tax rates may be low or zero, and the community college may be almost completely dependent on tuition. The actual tuition rates and fees set by local trustees vary greatly. Increased legislative support would be necessary to provide a way to offset all or a portion of the lost tuition and fee revenue. Replacing this lost revenue equitably would be difficult.

- Charges to students at comprehensive universities should be maintained at approximately current affordability levels.

  On average, charges to students at comprehensive universities are similar to those of peer institutions, though higher than those at peer California State University System

universities. Keeping charges at current levels would provide a reasonable compromise between institutions' desire for more revenue and the need to keep higher education affordable.

Because affordability at Texas comprehensive universities has declined significantly in recent years as tuition and fees have increased, a balanced financing policy might include limiting tuition and fee increases at these institutions to increases in median family income or some other measure of economic performance. Under this proposal, institutions would have great flexibility in setting tuition and fees as long as the average per-FTSE charges to students meet this or a similar affordability condition.

To implement this proposal, institutions with per-FTSE charges that are lower than sector averages should be allowed to increase charges up to the average amount. Institutions with per-FTSE charges above the average would be "grandfathered," with no further increases allowed until their charges meet the sector average.

- Doctoral/research universities should be allowed to set charges to students if specified conditions are met.

  An appropriate set of conditions might include: (a) graduation of African American and Hispanic students meets targets set in the *Closing the Gaps* performance system; (b) total charges to students do not exceed a specified percentage of expenditures for need-based gift financial aid; and (c) charges to undergraduate students are not used to subsidize graduate programs. Other conditions could be equally important.

  Doctoral/research universities represent a special opportunity, because they can be more selective in admitting students and because they have access to more financial and other resources. Their students are less likely to be from low-income families and are more likely to persist and graduate. Based on what is known from price elasticity studies, increasing charges to students at these universities is unlikely to result in decreased enrollments. Increased charges would increase total revenue available to institutions, which would support the Board's excellence goal. If increased charges are accompanied by appropriate increases in need-based financial aid, institutions should be more successful in enrolling and graduating African-American and Hispanic students, thus supporting the Board's participation and success goals.

  Both the Washington Higher Education Coordinating Board study of national tuition rates and College Board data indicate that Texas has not gone as far as other high-performing states in allowing tuition and fee differentiation among its four-year institutions. According to College Board data for 2001-2002, average undergraduate tuition and fee charges at University of California institutions are 125 percent higher than charges at California State institutions, and average charges at the University of Illinois at Urbana-Champaign and the University of Illinois at Chicago are 64 percent higher than charges at other Illinois public universities. In contrast, charges at Texas' five most expensive public universities are only 38 percent higher, on average, than charges at the rest of Texas public universities. Texas should consider whether allowing greater tuition differentiation across higher education sectors and levels could increase both revenues and the mission distinctiveness that seems tied to high quality in other states.

This proposal is also consistent with Carnegie Commission and Institute for Higher Education Policy recommendations that charges be increased for expensive graduate and professional programs that result in major financial benefits to recipients. It encourages excellence by subjecting programs to market forces. Also flexibility in setting tuition and fees should encourage efficient use of institutional resources. The resulting revenue stream from charges to students should be more similar to that of institutions in the University of California System. Finally, the conditions would focus these institutions on increasing the number of African American and Hispanic students graduating from the state's most selective universities, which is an important state goal.

Some of the state's graduate/research institutions would be likely to have more pricing power and more ability to raise funds through increased tuition than others. Some have warned that this could weaken the financing and competitiveness of the graduate/research institutions with less pricing power.

- Graduate and professional tuition and fees should be allowed to increase significantly if adequate financial support is provided for students. Tuition and fee revenues in these programs should cover a higher percentage of program cost.

  According to a recent national tuition and fee study by the Washington Higher Education Coordinating Board, Texas resident graduate tuition is considerably below peer and national levels. Resident graduate tuition in Texas public universities is 40 percent below the national average, according to the Washington study[4]. Resident undergraduate tuition is only 14 percent below the national average. Tuition in professional programs also seems low in Texas, although that will not be discussed here in any detail.

  The Washington study, which looks at a stratified sample of each state's universities, shows that a typical Texas undergraduate student (taking 30 semester hours a year) pays more in required tuition and fees than a typical graduate student (taking 20 hours per year.) This situation is further exacerbated by the fact that Texas has a generous non-resident tuition exemption program, so that many international and out-of-state students pay resident tuition. Consequently, the state's current tuition and fee structure for graduate students is not consistent with the principles that students should pay more for programs that are more expensive to offer and that they should pay more for programs that prepare them for higher-paying jobs.

  Defenders of the generous pricing that Texas public institutions provide to non-resident students, both undergraduate and graduate, point out the economic benefits that skilled and hard-working in-migrants from other states and countries bring to the state. They also point out that our institutions would be less competitive in recruiting the best students if nonresident tuition were raised, or if limits were put on the number of non-resident tuition waivers that could be awarded. The Coordinating Board staff is developing data that would help indicate the relative benefits provided to the state by resident and nonresident students.

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[4] *2001-02 Tuition and Fee Rates: A National Comparison*, Washington Higher Education Coordinating Board, Olympia, Washington, January 2002.

What percentage of gross charges should be covered by financial aid? ...and by what types of financial aid?

Educational researchers often classify states as either low-tuition/low-aid states or high-tuition/high-aid states. High-tuition/high-aid states attempt to maximize tuition revenue by charging high tuition and then minimizing its effect on low-income students by offering relatively high levels of student financial aid for low-income students.

Traditionally, Texas has been a low-tuition/low-aid state, but in recent years it has increased both tuition and fees as well as need-based student financial aid. Precise comparisons are difficult to make, but Texas appears to rank midway among the states in charges to undergraduate students and financial aid provided to offset a portion of those costs.

In an effort to gain a better understanding of what portion of charges to students should be offset by financial aid, tuition and fee revenue and financial aid expenditures were examined at representative institutions in Texas and the other 10 most populous states. Data were extracted from the National Center for Education Statistics Integrated Post-Secondary Education Data System (IPEDS). These data are drawn from annual financial reports and reported to IPEDS by the institutions. Total tuition and fee revenue and expenditures for financial aid expenditures were divided by student headcounts, so the results are somewhat different than survey data based on a theoretical resident undergraduate student taking a full course load. As a result these numbers represent a composite of undergraduate and graduate students, resident and non-resident students, and part-time and full-time students.

These data are presented in the following three tables, one for each sector. The "Percentage" column indicates how much of tuition and fees is offset by financial aid. Because financial aid is provided for expenses outside tuition and fees, the percentage may exceed 100 percent, as it does for some community colleges in the third table. The "Difference" column represents a rough estimate of what the average student at these institutions pays out-of-pocket. Again, financial aid expenditures may exceed tuition and fees.

Comparison of Average Per-Student Tuition and Fees and Financial Aid at Selected Doctoral/Research Universities in Texas at the other 10 Most Populous States

State/Institution	Tuition & Fees	Financial Aid	Percentage	Student "out-of-pocket" cost
Texas – The University of Texas at Austin	$4,635	$1,832	40%	$2,803
California – The University of California at Berkeley	$7,699	$3,502	45%	$4,197
Florida – University of Florida	$2,975	$1,115	37%	$1,860
Georgia – University of Georgia	$4,019	$2,788	69%	$1,232
Illinois – University of Illinois – Urbana Champaign	$5,321	$2,600	49%	$2,721
Michigan – University of Michigan – Ann Arbor	$12,765	$4,187	33%	$8,577
New Jersey – Rutgers – New Brunswick	N/A	N/A		
New York – SUNY at Buffalo	$4,365	$1,037	24%	$3,328
North Carolina – University of North Carolina	$4,881	$2,002	41%	$2,879
Ohio – Ohio State University	$6,647	$1,615	24%	$5,032
Pennsylvania – Pennsylvania State University	$8,559	$1,211	14%	$7,348

Source: National Center for Education Statistics Peer Comparison System, FY 2000
Tuition and fees = reported tuition and fee revenue divided by total headcount enrollment
Financial aid = reported expenditures for scholarships and fellowships divided by total headcount enrollment
Note: This "average per-student tuition and fees" number is calculated by dividing the total amount of tuition and fees collected at the institution by the total number of headcount students. As a result, this average corresponds to an average price paid across undergraduate and graduate students, full-time and part-time students, and resident and non-resident students. The average also include all reported fees, not just required fees.

The table for doctoral/research universities offers a couple of interesting comparisons. The "Percentage" column shows that The University of Texas at Austin offers a similar amount of financial aid (as a percentage of tuition and fees) as do a number of doctoral/research universities in the other 10 most populous states. However, the "Difference" column shows that the net cost of education to an average student at The University of Texas at Austin is less than the average ($4,130) paid by students at the comparison group universities.

Comparison of Per-Student Tuition and Fees and Financial Aid at Selected Comprehensive Universities in Texas at the other 10 Most Populous States

State/Institution	Tuition & Fees	Financial Aid	Percentage	Student "out-of-pocket" cost
Texas – Sam Houston State University	$2,412	$743	31%	$1,669
California – California State University at San Bernadino	$2,372	$1,351	57%	$1,021
Florida – University of North Florida	$1,643	$528	32%	$1,115
Georgia – Valdosta State University	$2,031	$1,718	85%	$313
Illinois – Southern Illinois University at Carbondale	$3,144	$897	29%	$2,247
Michigan – Western Michigan University	$3,674	$1,020	28%	$2,654
New Jersey – Montclair State University	$3,303	$1,158	35%	$2,145
New York – CUNY at Brooklyn	$2,786	$1,505	54%	$1,280
North Carolina – University of North Carolina at Charlotte	$2,754	$658	24%	$2,096
Ohio – Youngstown State College	$3,896	$1,608	41%	$2,287
Pennsylvania – Bloomsburg University of Pennsylvania	$4,586	$1,106	24%	$3,480

Source: National Center for Education Statistics Peer Comparison System, FY 2000
Tuition and fees = reported tuition and fee revenue divided by total enrollment
Financial aid = reported expenditures for scholarships and fellowships divided by total enrollment.
Note: This "average per-student tuition and fees" number is calculated by dividing the total amount of tuition and fees collected at the institution by the number of headcount students. As a result this average price corresponds to an average across undergraduate and graduate students, full-time and part-time students, and resident and non-resident students. The average also include all reported fees, not just required fees.

The table for comprehensive universities is also instructive. The "Percentage" column shows that Texas comprehensive universities offer significantly less financial aid (as a percentage of tuition and fees) than do some of the comprehensive universities in the comparison group. The last column, on the other hand, shows that the net cost to Texas students is about average ($1,864).

Comparison of Per-Student Tuition and Fees and Financial Aid at Selected Two-Year Colleges in Texas at the other 10 Most Populous States

State/Institution	Tuition & Fees	Financial Aid	Percentage	Student "out-of-pocket" cost
Texas – Tyler Junior College	$1,057	$748	71%	$309
California – Barstow College	$133	$349	262%	($216)
Florida – Central Florida Community College	$1,380	$1,492	108%	($112)
Georgia – Bainbridge College	$1,134	$1,249	110%	($115)
Illinois – Carl Sandburg College	$973	$671	69%	$302
Michigan – Mid Michigan Community College	$1,561	$742	48%	$819
New Jersey – Ocean County College	$1,742	$435	25%	$1,307
New York – CUNY Bronx Community College	$2,410	$2,634	109%	($224)
North Carolina – Catawba Valley Community College	$779	$256	33%	$523
Ohio – Cincinnati State Tech & Community College	$2,539	$819	32%	$1,719
Pennsylvania – Butler County Community College	$1,451	$518	36%	$933

Source: National Center for Education Statistics Peer Comparison System, FY 2000
Tuition and fees = reported tuition and fee revenue divided by total enrollment
Financial aid = reported expenditures for scholarships and fellowships divided by total enrollment
Note: The "average per-student tuition and fees" number is calculated by dividing the total amount of tuition and fees collected at the institution by the number of headcount students. As a result this average price corresponds to an average in-district and out-of-district students and full-time and part-time students. The average also include all reported fees, not just required fees.

This last table displays wide ranges of variation across the community colleges sampled. In general, the percentage of financial aid and net costs to students in Texas are close to the average ($494).

There may be no "right" answer to the question of what portion of charges to students should be offset by student financial aid, but a policy could be developed from a set of "principles" related to this question:

- Different policies should apply to different sectors of higher education. A policy that is appropriate for doctoral/research universities may not be appropriate for two-year colleges.

- Financial aid for the first two years of an undergraduate education should be provided through grants primarily. Research shows that low-income students are often reluctant to incur debt for higher education, so initial financial aid packages that include support through loans discourage these students' participation in higher education. Studies also show that students who complete the first two years of college are much more likely to complete baccalaureate degrees. Emphasizing the use of financial aid in the form of loans for a student's subsequent years of college would also help reduce graduates' debt loads.

- Texas should model its tuition and fee/financial aid policies on those of other states, like California, that are seen as having the most successful higher education programs.

The principles above suggest these recommendations:

- Texas public two-year colleges should be low-tuition institutions that minimize the need for financial aid. Charges to students should be maintained at levels low-enough that most students who live at home would not need student financial aid.

- Texas public comprehensive universities should be characterized by moderate charges to students, ready availability of gift funds for lower-division students, and ready availability of loan funds for upper-division and graduate students. Lower-division students should receive most of their financial aid in the form of gift aid. Because at least some of these institutions are populated with large numbers of low-income students, relatively high amounts of financial aid may be needed to make these institutions affordable. The current split between charges to students and financial aid appears to be similar to comparison institutions in other states.

- Over time, Texas public doctoral/research universities should be developed as higher-tuition-higher-aid institutions, with more increases in charges for graduate and professional students than for undergraduate students. Graduation of undergraduate students is a high probability at these institutions because the institutions are selective. Because students at these institutions tend to have relatively higher family incomes, higher charges to students do not affect student enrollment decisions as much as they do at other types of institutions where students tend to have lower family incomes. If higher levels of tuition are accompanied by higher levels of financial aid, then more low-income students will enroll and graduate. Lower-division students should receive most of their financial aid in the form of gift aid. Upper-division and graduate students should receive a higher percentage of their aid through student loans. Providing financial aid in amounts equal to 50 percent of tuition and fee revenue or limiting the difference between per-student tuition and fees and per-student need-based financial aid to $4,000 (the average student "out-of-pocket" difference between tuition and fee charges and financial aid of the representative institutions looked at earlier from the 10 most populous states) would make these institutions relatively affordable.

How much revenue is needed by institutions of higher education to achieve the goals of *Closing the Gaps*?

This question was considered in early 2002 when the Board approved funding formulas for the 2004-2005 biennium.

Briefly, the Board-recommended formulas published in April 2002 consisted of the following appropriations and percentage increases for two-year colleges and universities for the 2004-2005 biennium. Minor adjustments were made at the July 2002 meeting (not reflected in these tables).

Sector	Recommended Appropriation (millions)	Increase over Current Appropriation
Community and technical colleges	$2,117.1	25.2%
Universities	$4,133.7	15.5%

What percentage of Educational and General funding should come from state sources and what percentage should come from other sources?

Sources of educational and general funding vary considerably among Texas public institutions of higher education. Each community college district generates a significant portion of its revenue from local property taxes, but other types of institutions do not have similar taxing authority. Some research universities receive a significant portion of their revenue through restricted contracts and grants from the federal government and other sources, while many other institutions receive little or no such funding. A few institutions have endowments that provide significant support, while others have virtually no endowment income. All public institutions receive a portion of their revenues from state general revenue appropriations, but the sizes of the portions vary considerably among institutions.

State general revenue appropriations have accounted for a decreasing portion of total revenue for most higher education institutions in Texas and elsewhere primarily because revenue from charges to students and from other activities have increased at a faster rate than state general revenue. In general, however, general revenue appropriations have kept up with enrollment growth and inflation, but other revenue sources have grown at faster rates.

The following table[5] shows the percentages of each sector's E&G expenditures that were supported by state general revenue in FY 2001.

Sector	FY 2001 E&G Expenditures	FY 2001 G.R. Appropriation	G. R. Percentage
Two-year colleges	$2,428,178,137	$895,589,304	37%
Comprehensive universities	$2,450,572,267	$1,155,289,286	47%
Doctoral/research universities	$2,858,460,932	$967,042,172	34%

Several principles should be considered in determining the amount of revenue that should be provided from state sources:

- The portion of current operating funds derived from state general revenue should differ among higher education sectors.
- General revenue appropriations provide the core financial support for Texas public higher education institutions and should not fluctuate considerably from year to year.
- The portion of total expenditures derived from state general revenue for any institution should be similar to that of successful peer institutions in Texas and other states.
- The beneficial effect of tuition increases in providing institutions of higher education with needed revenue should not be offset by a corresponding decrease in state-provided general revenue. Such an action would simply increase the cost of higher education and make it more difficult for the state to meet *Closing the Gaps* goals.

Comparing the financing systems of Texas and California shows some major differences in the way groups of institutions are currently funded. If Texas higher education were to take

[5] Taken from FY 2001 Exhibit C, Institutional Annual Financial Reports.

California as a best practice model, the relative proportion of revenues coming from different sources might be targeted to change over time.

- For two-year colleges, the Texas Legislature and institutions could, over time, change the overall current funds revenue distribution to become closer to that of California as shown in the following table[6]:

E&G Revenue Source	Texas FY 2001	California
State General Revenue Appropriation	37%	61%
Local Taxes	21%	36%
Charges to Students	19%	4%
Other Sources	23%	0%

Source: California numbers are derived from analysis of financial data provided by the California Post-Secondary Education Commission. Texas numbers are derived from institutional financial statements.

Making this change would significantly lower charges to students. In exchange, it would be necessary to increase revenue from state sources, local taxes, and other sources. It should be noted that in California, unlike Texas where over one-third of the property value in the state is not in a taxing district, all areas of the state support community college districts through local taxes. The California figures could be taken as an overall goal for the sector, although the distribution would of necessity vary among institutions. For example, small tax bases or low tax rates in some districts would make it difficult for them to meet the local tax revenue goal, and those institutions should either offer services at a lower level or augment their revenue from other sources. If adopted, this goal would provide information that would allow each district to measure its progress toward the state's expectations.

The problem of providing equitable resources to each district, given unequal per-student tax effort and tuition rates would be a major problem.

- For comprehensive universities, the Texas Legislature and institutions could, over time change the distribution of current funds revenue as shown in the following table:

E&G Revenue Source	Texas FY 2001	California
State General Revenue Appropriation	47%	76%
Charges to Students	23%	15%
Other Sources	30%	10%

Source: California numbers are derived from analysis of financial data provided by the California Post-Secondary Education Commission. Texas numbers are derived from institutional financial statements.

[6] Taken from FY 2001 Exhibit C, Annual Financial Reports.

These percentages reflect averages for the sector. Figures for individual institutions would be expected to vary from that average, depending on each institution's stage of development, local demand for services, and other factors.

The dollar values included in this proposal were derived from an analysis of funding provided to institutions in the California State University System. This system consists of 21 universities located across California. Their primary mission is teaching. California State Universities offer undergraduate and master's degrees (but no doctoral degrees) and perform limited amounts of research, but have active local economic development programs.

- For doctoral/research universities, the Texas Legislature and the institutions could, over time, change the distribution of current funds revenue as follows:

E&G Revenue Source	Texas FY 2001	California
State General Revenue Appropriation	34%	35%
Charges to Students	22%	17%
Federal Contracts and Other Sources	44%	48 %

Source: California numbers are from National Center for Education Statistics data for the University of California at Berkeley. Texas numbers are derived from institutional financial statements.

These percentages reflect averages for the sector. Figures for individual institutions would be expected to vary from that average. Texas doctoral/research institutions vary widely in their stage of development and many could not come close to meeting these goals at this time.

This comparison table was derived from an analysis of funding provided to the University of California at Berkeley. This institution has fewer overall students than The University of Texas at Austin, and has a somewhat higher percentage of graduate and professional students, but is similar to UT-Austin in having no medical or dental school. Under a California model, doctoral/research universities would have significantly more per-student funding than they do now. However, they would get significantly more funding from federal and state research grants and other sources.

Summary and Recommendations

The following summary recommendations focus on three key principles, all directly aligned with *Closing the Gaps*: Flexibility, Adequacy of Funding, and Adequacy of Financial Aid. The performance system for the state's higher education plan, *Closing the Gaps*, should be used to measure how well the state's system of higher education is working.

These principles are recommended as the basis for a balanced financing policy for Texas public colleges and universities.

- ***(1)) Flexibility in setting charges to students. As long as the average charge to students is not raised or lowered significantly, all institutions of higher education should have flexibility in setting charges to students for the purposes of increasing efficiency and achieving the participation, success, excellence, and research goals of* Closing the Gaps. *The flexibility to increase average charges to students should be given to institutions when specific conditions are met to preserve and enhance affordability and meet the goals of* Closing the Gaps.**

The first type of flexibility would allow institutions to give discounts to students taking courses in off hours and offer flat rate tuition to encourage students to complete their degrees more quickly. The second type of flexibility would allow institutions to increase charges to students, as long as they met certain conditions.

General academic institutions should be given flexibility to set charges to students if they enter into a compact with Texas that guarantees maintaining affordability and meeting the central targets of the *Closing the Gaps* plan, including closing the gaps in participation and success for major demographic groups of Texans.

Each group of institutions should address a different educational marketplace:

Two-year colleges should continue to provide a low-cost portal to a wide range of academic and technical higher education services.

Comprehensive universities should maintain current levels of affordability and offer quality teaching programs.

Doctoral/research universities should be developed as higher-tuition/higher-financial-aid institutions offering national-quality teaching and research programs.

- ***(2) Adequacy of funding. To ensure that each institution of higher education receives adequate funding to meet* Closing the Gaps' *goals, increased charges to students that might result from tuition flexibility should result in a net increase in revenue to institutions.***

Greater flexibility to raise tuition should not become simply a way to shift the cost of higher education from the state to the student.

The higher education financing system should also contain more structural incentives that encourage institutions to increase revenue streams from sources other than general revenue, including research funding, royalties from intellectual property, and other activities.

- ***(3) Affordability: Adequacy of Financial Aid. The state's system of higher education must continue to be affordable for the citizens of Texas. Affordability is essential to most of the goals of Closing the Gaps. Gift aid needs to increase to match rising tuition and fees for students with financial need. Student loans should not substitute for low charges to students and need-based gift aid. Students enrolled in the first two years of undergraduate education, particularly, should be the main priority for the state's need-based gift aid.***

It would be highly desirable to pursue a joint guarantee from the state and institutions to provide grant aid to cover tuition and fees for students who have completed the recommended high school curriculum and whose family income is below a specified level. For students who have completed the recommended high school curriculum and whose family income is at or above a specified level, such grant aid may be provided.

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